RICHARD RUSSELL'S **DOW THEORY LETTERS, INC.**

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August 10, 1983 **LETTER 867**

July 29, DJIA 1199.22; PTI 1680; A-D Ratio –14.63
Aug. 5, DJIA 1183.29; PTI 1678; A-D Ratio –15.36

THE PICTURE: Every once in a while, maybe once, twice, three times a year, a writer has to earn his living in this business. Now is one of those times.

Question: Russell, you've been telling us to watch certain points on the D-J Averages. And you've been stressing the action of the PTI. What's happened?

Answer: The PTI has been walking up a trendline that has been in force since last August. That means that the PTI has been in a bullish trend for the past eleven months. While this was happening, I never had any problem with this market. Despite rising interest rates, despite all sorts of dire predictions about everything from a collapse of world debt to the demise of the US housing and auto businesses, I could remain solidly bullish.

Last week we had our first change in the PTI. Last week the eleven month rising trendline was decisively broken and we now have a top in the PTI of 1698 recorded on July 26.

Question: All right, but at what point do you say that the PTI is flashing a major danger signal?

Answer: Here's what I watch in the PTI. (1) I watch to see whether the PTI holds above, or breaks below a rising trendline (it broke last week). (2) I watch to see whether the PTI begins to form a definite new trend–for instance, now I will watch to see whether a definite downtrend forms in the PTI. (3) In the past I have used the 21-week moving average of the PTI for major trend signals. The 21-week MA of the PTI is now at 1622 and rising at the rate of about 8 points a week. The PTI is still well above its 21-week MA, as you can see on the page 2 chart.

Question: Russell, what about the Averages?

Answer: The market loves to test investors with weak hearts. And if there's anything the market loves more than that, it's to confuse us all (particularly the so-called "experts"). On August 4 the Dow dropped to 1283.09, just slightly below its June 8 low of 1185.50. And on the same day the Transportation Average sank to 540.41, just a few points above its May 19 low of 538.07.

So we have a *non-confirmation* in that Industrials have broken below their May-June trading range while the Transports are still hanging on. Now this kind of action is tricky, very tricky. On the face of it we have a hopeful situation in that the market is now fairly oversold, and the Transports have not yet confirmed on the downside. But Wall Street loves to make it diffucult, and we could still get a slide in which Transports could break their 537.07 low of May 19. In that case, I would want to see whether there was any real power behind the move, whether volume increased on the penetration and whether there was any follow-through on the downside.

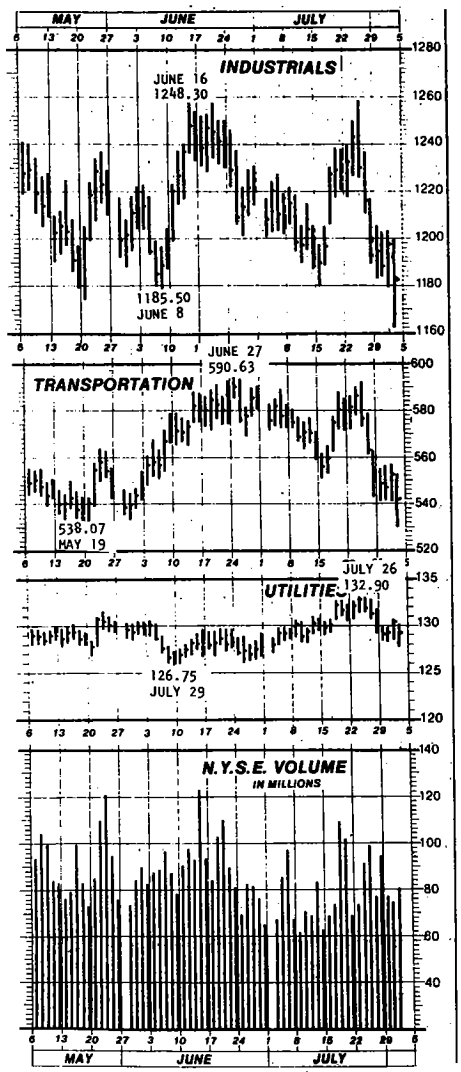
Let me put it this way: we are at a very difficult juncture in the market, and we are in an area where stockholders could easily panic. But my own feeling is that the downside momentum should ebb soon, and that we are fairly near rallying time.

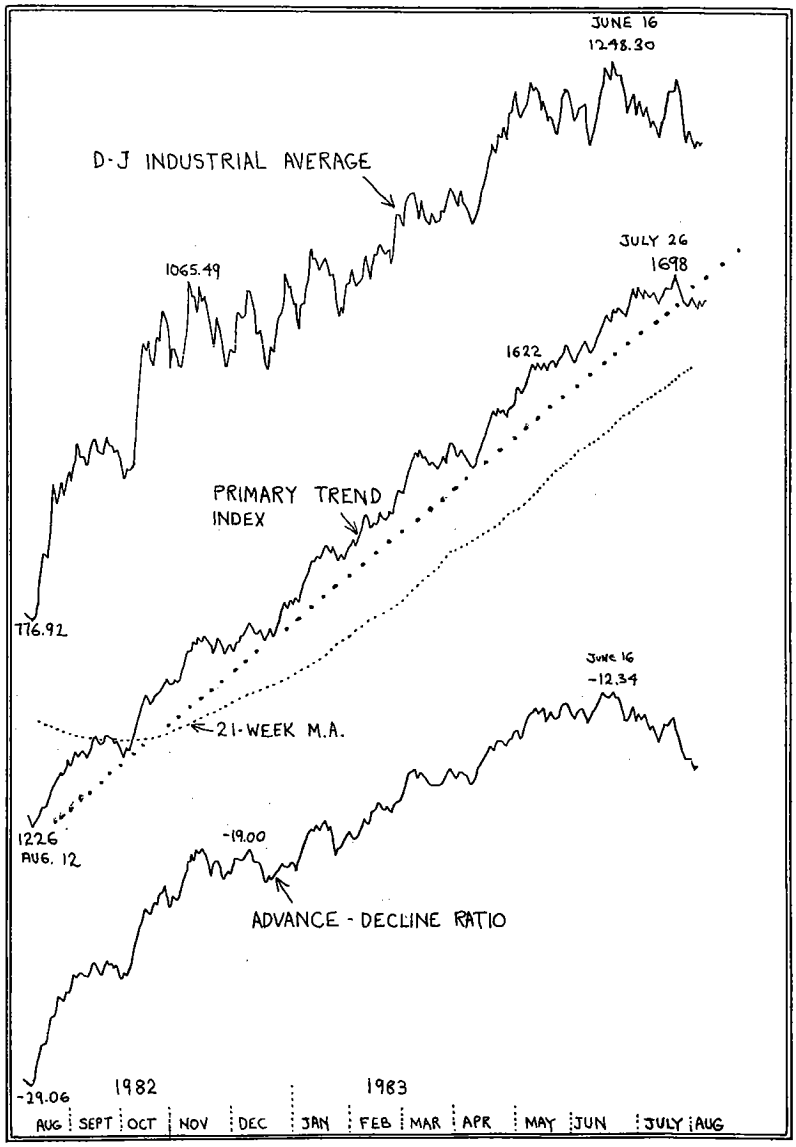
Question: Russell, in the past you have mentioned moving averages in connection with the market trend. What are you looking at now?

Answer: I have (and still do) use all kinds of moving averages in my efforts to gauge the trend. E. George Schaefer, the great Dow Theorist of the 1940s through the 1970s, used a simple method based on the position of the Dow and its own 200-day moving average. And as readers know, I am partial to simplicity.

On page two is a chart of the Dow and its 200-day MA (chart courtesy of Holt Advisory, 290 Post Rd., Westport, CT 06880). Note that the Dow has held above the 200-day MA for 48 consecutive weeks. In fact, the MA has, so far, not even been tested. But today the test is on, and the Dow has come within striking distance of the 200-day MA–which now stands at roughly 1155.

In severe secondary corrections the Dow will come down and touch or temporarily penetrate the 200-day MA. And this could easily happen here in August. But I would take it as constructive





if the Dow holds above the 200-day MA. That would be quite a feat, considering that the Dow has held above the 200-day MA for almost the entire first year of the bull market..

Question: Is this a secondary reaction or is it a bear market? That's what I want to know.

Answer: This is a tough question to explain to new subscribers and to neophytes in the stock market. But when the Averages turn down from a high area following a major rise it is always possible that a bear market has started. The fact is that there isn't a man alive who can know *with certainty* whether it's a correction or a bear market that we are now facing. At this point, EVERYBODY from Joe Granville to Marty Zweig to Paul Adolph Volcker is guessing about what we are dealing with. The real story (unfortunately) will only be told AFTER the fact.

Question: So what do we do?

Answer: My subscribers (if they listened to me at all) are in T-bills, T-notes, no-load (growth) funds and defense stocks. Consequently, I don't think there is too much we have to do now. The one thing I might recommend is cutting back some of your no-load funds, and you do this by calling the fund and switching into a money market fund.

Question: Wouldn't this be a strange place for a bear market to start?

Answer: A bear market can start any place–at any time. In fact, bear markets usually start when nobody believes such an event is possible and when the timing is totally "inconvenient" for the average investor.

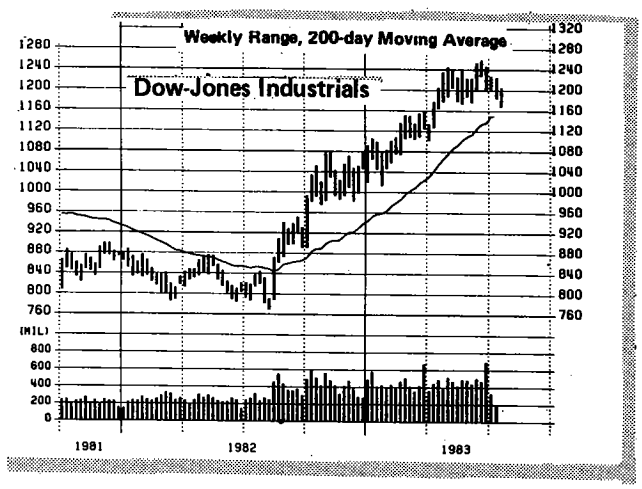
However, there is one thing to consider. The stock market started up last August, and the Dow advanced roughly 470 points without a single important correction. In doing so, the Dow rose to a record high of 1248.30. Now I can't remember any advance in the history of the Averages where the Dow rose to record highs in a single uncorrected leg–then collapsed into a primary bear market.

The more expected development would be a correction (as now), even a severe correction (as per 1933-34, and then a resumption of the bull market to new all time highs (as occurred in 1937).

The single wave of 1982-83 is a very important consideration, and I don't want my subscribers to dismiss it lightly. What I am saying is that bull markets almost always come in upward waves (legs) of two, three or more–each advance separated by a correction. So far, we have only seen one upward leg in this bull market, and if the June 16 Dow high of 1248.30 proves to be THE high, that would be a most unusual (really unprecedented) event! The odds suggest that there will be one (or more) additional upward legs before this bull market breathes its last.

Question: Russell, what about the fundamentals here?

Answer: I've never seen the fundamentals more confused, more murky. In fact, at this point I would say that we are really much better off sticking to the technical situation than we would be trying to unravel the fundamentals.



There is one situation that I would like to touch on however, and this is written just after coffee and a bran muffin with Mr. Melvyn Lippman. The world is now going on a military binge, or should I say a bigger military binge than ever before. Every nation, every continent, is arming to the teeth. On top of that the world is choking on social programs. And on top of even that, we have the picture of the enormous growing world debt. So what is going to happen?

I can tell you this. No one is going to disarm. And no one is going to halt the process of buying (or borrowing to buy) weapons. The military build-up is astronomical and growing, and how all this is going to be paid for I don't know and nobody else does either. But governments (as I've so often stated) will do WHATEVER THEY HAVE TO–to perpetuate themselves, and the perpetuation device of today is the MILITARY. No military, no buy list for the latest weapons, and you do not survive!

You know why gold isn't taking off in the face of rising commodity prices and huge debts and possible debt breakdowns and possible bank collapses? The reason (again) is that the situation is basically deflationary. In the face of a deflationary environment and very high real interest rates, no one wants gold. Gold as an investment is dead. It doen't rise and it doesn't fall apart. No one knows what to do with it. And it just sits there, budging slightly this way or that in response to the latest crisis.

But the fundamentals are just as I've written them. And before it's all over, the only games in town may be defense stocks (are these the gold of the 1980s?) and T-bills. The no-load funds we can view as "insurance" against major market rises, but more and more I'm thinking that over the next few years there will be two places to be–Treasury bills (with occasional interest rate plays in the T-bonds) and defense stocks. That's the way I see it–no kidding and no apologies.

Question: I don't want to name names, but a number of leading analysts and market letter writers have been saying that we are on the edge of a market crash. They have maintained that this whole 1982-83 rise was an incredible, abnormal bear market rally, and that when this rally ends, the market will fall over and smash to new lows. What do you think of this?

Answer: I have an adage which I have named Russell's Rule No. 9. It runs like this: "Keep your eye on the smart analyst who has been wrong for a long time. He is probably going to be right very soon." And the corollary is this: "Watch the smart analyst who has been right for months (even years) on end. He is very close to the time when he is going to be horribly wrong."

Now a number of veteran letter writers have stayed bearish all through the incredible 1982-83 rise, a rise that has taken the Dow up better than 470 points. And I ask myself, "How long can these guys be wrong?" Now I know it takes an arrogance to stay wrong (and maybe even short) through an historic 470 point rise in the Dow. But it has bothered me that these stubborn bears haven't been right for eleven straight months. And I ask myself, "Could they be right now? Now, when nobody is really taking them seriously any more."

Question: What do you conclude from these fellows?

Answer: I never laugh at anybody in the advisory field. I listen, and hopefully I learn. My gut feeling (for what it's worth) is that this is not the beginning of a bear market. My guess is that we are in a secondary correction of undeterminable severity, and that when the correction has run its course the market will head up again–towards and then over the highs. But that will take time. Remember, this market has been climbing skyward for eleven straight months without anything like a worthwhile correction. And the market is tired. But to say that it's all over is something else again. The odds are always against a change in the primary trend, and my feeling is that this is not the time to get hysterical. One can be cautious here–but nothing has been proved yet.

INVESTMENT POSITION: If the primary trend has changed, I can't prove it by my work. The bull is still in this box, and I'm not calling for any huge change in our investment stance. At over 12%, the long-term Government bonds are pretty attractive, but I would hold most of my liquid assets in T-bills. cut back (maybe up to 30%) on your no-load funds if you're nervous, and sit with your defense stocks. What gold was to the 1970s, the defense stocks could be for the 1980s and (God forbid) even the 1990s. The world is going mad, and the heart of the madness is spelled–m-i-l-i-t-a-r-y.

THANK YOU: I recently announced a price increase for Dow Theory Letters to $225 a year and $130 for six months. I did, however, offer up to four additional years at the old price of $185 per year. I have received a great many multiple subscriptions at the old price, and most of these have come with personal letters. In fact, I have received so many letters that I simply cannot answer them all. But I do want to thank all these multiple-subscribers. Your additional years of Dow Theory Letters will, of course, be added on to BEGIN when your current subscription ends.

I will keep the multiple-year at $185 per each additional year (up to four years) offer open for another week. Oh yes, quite a few of the multiple-year subscribers have (1) expressed the hope that I remain in good health, (2) Told me in no uncertain terms to "be careful." I can only say this. I'm having a good time, I survived World War II as a bombardier, I survived a trip to NYC two weeks ago, I have survived 25 years in this difficult (some say crazy) business, and I have every intention of living well into my eighties or beyond (I'm very curious to see what the year 2000 looks like). Also, I have kids from 27 down to 2½, and the powers above have informed me that I had better stick around!

NOTES & QUOTES: Slowly but surely the public is beginning to find out about the massive transfer of Western technology to Russia. The New York Times, in a three-part series, discusses this on-going and dangerous situation. The Times notes that "several thousand" technology workers (from KGB or Soviet Secret Police) are now collecting information and actual technical devices and instruments from the West.

(continued page 5)

DEFENSE SECTION

Most or all of the defense information (but not stock information) is based on an exclusive arrangement with Mr. Melvyn Lippman of US Organization Chart Service, La Jolla, California.

With the next issue I am formally starting a DEFENSE SECTION for Dow Theory Letters. I am doing it for three main reasons. (1) The US is in trouble in defense, in order to even try to catch up to Russia vast changes will have to occur and massive amounts of new money are going to be spent. This will obviously have all kinds of repercussions and provide all kinds of opportunities for my subscribers. (2) The US-Russian defense race will have a great bearing on the lives of everyone in this nation. I don't have to tell you what will happen if the US loses the race. Thus, I am adding a defense section because I want my subscribers to be well informed. (3) I recently raised the price of Dow Theory Letters. I feel the new DEFENSE SECTION will more than make up for the price increase. In fact, I believe the Defense Section will prove to be worth the whole cost of Dow Theory Letters.

Aside from investment opportunities, the new DEFENSE SECTION will deal with (1) The validity of the Russian threat ("Is the threat real?"). (2) How the US may counter the Russian threat. (3) Where the US will have to direct its military energy. (4) Does the US have a "High Tech" edge? (5) Realistic strategic defense.

Over the next few years the people of this nation are going to have to make some important decisions regarding the defense of the United States. That program must be based, not only on what we would like or what we can afford, it must be based on the threats we face if we are to survive. With the help of Mr. Melvyn Lippman, I will provide my subscribers with significant and timely military and corporate intelligence data. The DEFENSE SECTION will provide a continuous flow of accurate and complete information. I believe that this information will be of vital interest and concern to my subscribers, and that it will be crucial in planning their future investments and in planning their life style.

Below is the latest tabulation of our recommended defense issues. All of these stocks are still recommended as long-term holdings. As you can see, it's correction time for the defense stocks as it is for almost all other issues. We'll just sit and bite our lower lips.

		Our Buy Price	Current Price	
NYSE	Harris Corp. (HRS)	49½	38 3/8	Defense stock average based on 1 share of each this week is 353.59
NYSE	LFE (LFE)	11 7/8	15 3/4	
NYSE	Planning Research (PLN)	14 3/8	17 1/4	
NYSE	Scientific Atlantic (SFA)	19	19 3/4	
NYSE	Tracor (TRR)	28 3/4	30 3/8	
NYSE	Electronic Assoc. (EA)	13	13 7/8	
NYSE	Varo (VRO)	19	15 7/8	
NYSE	Bolt Beranek (BBN)	37	71 3/4	
AMEX	BDM (BDM)	43½	76	% Increase is: 27%
AMEX	Dynalectron (DYN)	12 3/4	14 1/4	
AMEX	Moog B (MOGB)	15½	19 3/8	
AMEX	Systems Planning (SPZ)	7	11 5/8	
AMEX	American Science (ASE)	10½	9 3/8	
	Original purchase price			

As far as defense weapons, a revolution is underway. The old style of warfare is passing into history, and a new style has emerged. The new style will be high-tech, it will be super-sophisticated, it will ultimately move to outer space. With the new era will come new companies, many of them. And some of them will be destined to be the General Dynamics and IBMs of tommorow. Many of these "new" companies will be leaders in their particular field. And the fields will be exotic, relatively unknown to the average investor.

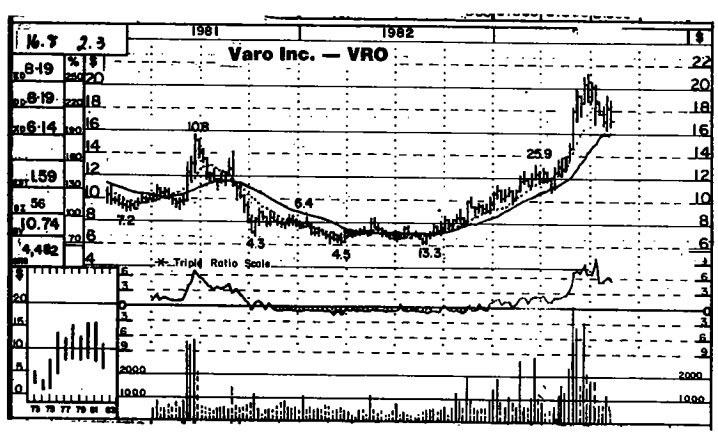
I plan to zero in on a number of these new era defense companies. In fact, my list of 13 defense stocks includes some of what I believe will be defense leaders of the "New Age."

Aside from the actual stocks, Mr. Lippman will keep me abreast of developments in the military of today and tomorrow. He is an expert on the subject of US and world defense, and his knowledge in this field is, to put it mildly, vast. Lippman does not deal with the defense picture as he would like it or as he hopes it might be. He deals with it factually and on the basis of reality. He gets the facts, he collates them, he applies his own logic and reason, and he comes up with many startling (and in some cases, frightening) conclusions.

As for Department of Defense Spending, the following are reliable estimates. Actual defense spending for 1980 $139 billion. For 1981 $159 billion. 1982 estimate $180 billion. The following are the lowest possible dollar projections: 1983 $202 billion, 1984 $225 billion, 1985 $249 billion. In other words, between 1983 and 1985 we can project a minimum increase in the Defense Budget of 23%. And that, when you are talking about billions of dollars, is A LOT!

Varo is one of my recommended defense stocks. Varo is a leader in military night vision equipment. It also makes weapons delivery systems, semi-conductor products and power conversion equipment. Varo should benefit from the coming military build-up, and I continue to recommend this stock.

This weekly chart shows Varo rallying to a new high, then being caught in the correction that has hit most of the technology issues. Volume has dropped drastically on the Varo correction, and the stock should find support at the 1981 peak of 15. Varo is a long-term holding, a company with a fine future considering what's coming up during the rest of the 1980s. (Chart courtesy of Mansfield, 26 Journal Sq., Jersey City, NJ 07306).



So, of course, what has happened is that the Soviets have been able to save thousands of man hours of research by obtaining Western information and devices. These efforts have also allowed the Russians to move ahead of the US in many areas.

Personally, I have always felt that this wholesale transfer of Western technology to Russia should be halted. It won't be easy, but where there's a will there's a way. Otherwise, we might find ourselves being defeated with technology and research, a large part of which originated in the US. It could happen–it really could happen!

PARIS, July 24 — Every year Western high technology with military applications, worth millions of dollars, disappears beyond the borders of the Soviet Union and its allies. Sometimes the Warsaw Pact's procurement effort is so effective that the embargoed equipment is even returned to the West for secret repairs.

American laws and North Atlantic Treaty Organization agreements ban the transfer of such sophisticated microelectronic and computer equipment. But the volume reaching the Eastern bloc is startling, according to Western intelligence experts.

When I say that defense orders are going to be a monster number in the economy of the 1980s, I'm not kidding. This little clip from last week's newspaper gives you a preview of things to come.

WASHINGTON (UPI) — The outlook for American industry grew brighter in June when new orders for factory goods jumped 3.9% to reach a record high level of $176.8 billion, the Commerce Department said yesterday.

The increase was the strongest since September 1980 and the seventh rise in eight months, although concentrated in defense aircraft and business computers.

Much of June's improvement in factory orders, adjusted for seasonal patterns but not inflation, was in defense supplies. When measured alone, their orders were up 74% from May.

I can't resist including this humorous piece from a recent New York Times. The article was written by Bryan Miller, and it tells all about what restaurants to avoid when you're on the road and why. This article strikes my funnybone, because (as veteran readers know) I've had a life-long battle with bad chow and the arrogant or stupid establishments who shovel this stuff out to the public under the guise of foods (or "cuisine").

¶ The Pepper-Mill Law: The disparity between a restaurant's price and food quality rises in direct proportion to the size of the pepper mill. Upon entering a restaurant, discreetly ask the manager or maître d'hôtel if you could take a look at the pepper mill (do so in a jocular, offhanded way to avoid suspicion, perhaps mentioning that you have a collection of unusual pepper mills from around the world and want to see what they've got). If it is a utilitarian instrument no larger than your fist, eat there. If, however, it resembles a deftly turned Louisville Slugger, tell the manager you think you left your car keys in the trunk and scurry out.

¶ The Billboard Law: When a restaurants mounts an expensive and repetitive billboard campaign that reads "30 Miles To Injun Joe's...20 Miles to Injun Joe's...5 Miles to Injun Joe's..." accelerate upon reaching Injun Joe's.

¶ The Barnyard Law: You will never go hungry in a restaurant that features a huge plastic barnyard animal out front or on the roof. Waitresses are generally pleasant at these places and the milk has a frothy head.

¶ The Altitude Law: The quality of food is in inverse proportion to a dining room's altitude, especially atop bank and hotel buildings (airplanes are an extreme example). There are some notable exceptions to this rule, of course, but I stand by it in general.

¶ The Chinese Law: Never eat Chinese food in Oklahoma.

¶ The Dishwasher Law: Contrary to popular notion, truck drivers know nothing about good restaurants. If you want a reliable tip, drive into a town, go to the nearest appliance store and seek out the dishwasher repair man. He spends a lot of time in restaurant kitchens and usually has strong opinions about them.

¶ The Law of Velocity: Bad food eaten at 60 miles per hour tastes better than bad food eaten in the restaurant that prepared it. This is a twist on the "Hot dogs taste better at the ball park" law. If you fall prey to a bad restaurant, ask the waitress for doggie bags so you can eat in the car.

¶ The Canine Law: Never eat in a restaurant that has a dog napping on or near the front stoop. It is probably this town's version of your gray meat steakhouse.

¶ The Law of Volubility: Your chances of getting an expensive platter consisting mainly of potato chips, pickle wedges and shredded iceberg lettuce is greatest in restaurants with (A) a long, poignant story on the menu decribing how the restaurant's name came about; (B) cute names for mundane dishes ("Davy Jones's Platter," for example); (C) excessive macramé in the dining room.

¶ The Local Color Law: If time permits, scan local weekly newspapers for church suppers, fund raisers and events such as Daughters of the American Revolution picnics. The price will be right for a family meal, and while the food may not be three-star, it will be copious and you won't have to leave a tip.

¶ The Survival Law: Never eat at a place called Mom's. Ever.

MAD: There are three industries that I consider "mad", and I have been intimately involved with two of them–and sometimes I think I'm almost in the third. The three are (1) the textile-clothing industry, (2) Wall Street, and (3) the movie business. I spent eight years as a textile designer back in the 1940s. Around 1950 I said to myself, "if you can survive in New York you can survive anywhere. And if you can survive in the textile business in New York, you can make a living on Mars or on the Gobi Desert.

But the lure of Wall Street caught me, and in 1957 I made the switch with the help of a lot of people, and the particular help of Barron's magazine and its editor, Bob Bleiberg. And I've been dealing with the stock market ever since.

But I've always loved movies, and I've always been fascinated by the film industry. You know, fashion, film and stocks are affected by just about everything including the weather, psychology, the money markets, timing, the economy, current taste, you name it.

Anyway, I drove up to Hollywood to see my buddy, Aaron Russo, last weekend. Aaron produced "The Rose" with Bette Midler, "Partners" with Ryan O'Neill, and the big comedy hit of this summer, "Trading Places" with Eddie Murphy. I just read a new script that Aaron will produce, and it's magical–and terrific.

My intuition has told me all along that Aaron will be the hottest producer in Hollywood. Within a year, I think this will be fact.

The movies are an amazing business, but I honestly can't decide whether making it in Hollywood is harder than making it on Wall Street. Actually, nobody "makes it" in either place. In Hollywood they say you're as good as your last picture. And it's been said that in Hollywood the single rule is–"Nobody knows anything." In Wall Street you're as good as your last trade. And anything you know, you can bet somebody else knows too. So you chase fame and fortune in Hollywood and on Wall Street. But the future is always uncertain. In each industry "it's a brand new business each year."

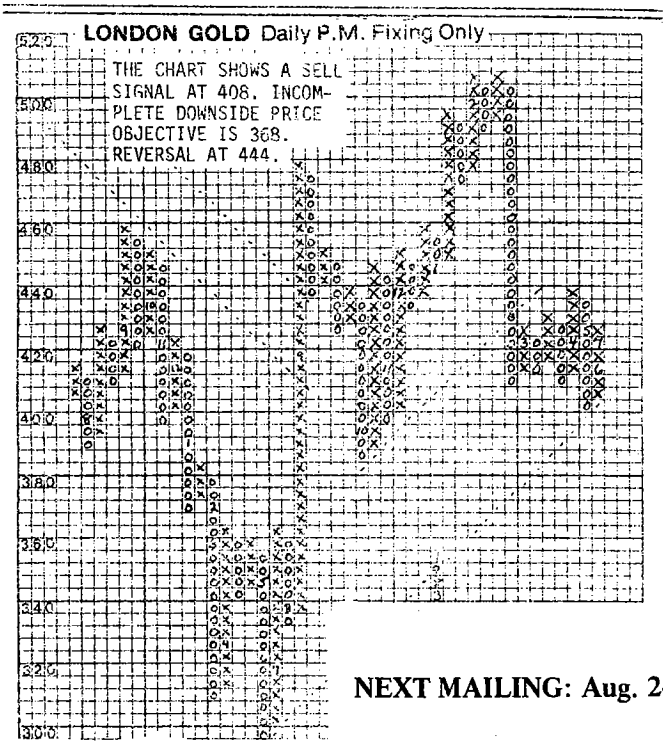
GOLD: Congress, as I indicated in the last Letter, is not exactly crazy about the idea of anyone making money in gold, silver or collectibles for that matter. Congress would love to make all precious metal profits subject to the penalties of ordinary short-term taxes (rather than capital gains). The IRS (like Congress) is not too fond of precious metals profits. Beginning July 1 silver and gold dealers must file returns whenever they back these metals from investors. The information that the IRS wants is your name, address and your identification number which is usually your Social Security number. This year the dealers only need to file an aggregate report on you, in other words, a report of the gross proceeds from all your sales. But starting January 1, 1984 dealers will be required to list each transaction in which they buy silver or gold from you. Since there are no futures contracts in gold coins, it is a QUESTION as to whether sales of gold coins must be recorded (my guess is that they will).

In an earlier part of this Letter I told why I thought the world situation was basically Deflationary. The whole world from Egypt to the US to Russia to El Salvador is spending its head off on arms–and there is no end in sight. the resulting debt build-up is unsustainable. It will ultimately end in sky-high interest rates, a collapse in the debt structure and world depression. It's not a matter of "whether" as far as I'm concerned, it's a matter of "when".

And I think this is what gold is measuring. Gold has stood still over the past year in the face of international crisis, rising commodity prices, a massive rise in the US money supply. And I ask myself, "What in the world would it take to move gold up to say, 445, where we would receive an initial bullish signal? Well, my answer is that it would take a change in the deflationary sub-structure of the world–and I don't see that happening.

I know the gold-bulls are mad at me, I know that gold holders don't want to take in what I've been saying over the last year. But I've been right about gold and the hard money people who have been telling you to "load up" with the metal have been wrong–at least so far.

Last week one widely read advisory said, "Please. Pretty please! If you haven't brought your gold portfolio up to full strength–worse, if you haven't purchased any gold at all–do it now. The market isn't going to wait much longer. We think the price of gold will climb back to $500 an ounce before the end of this year. After that, the sky's the limit as inflation heats up in 1984-86."



NEXT MAILING: Aug. 24

That's the bull view of gold. And I disagree. I don't think it's going to happen, but I won't be stubborn. If gold (spot) rises to 445, I'll start to rethink my gold scenario–but ONLY if gold hits 445.

Meanwhile, this P & F chart of gold (courtesy of Chartcraft, Larchmont, NY) tells me that if gold goes to 400 spot, it's going to be in trouble–maybe big trouble.

	Dow	PTI	Gold
Current	1183	1678	413
5-wk MA	1206		418
13-wk MA	1205		422
50-wk MA	1105		424
3-wk MA		1678	
8-wk MA		1671	
21-wk MA		1622	

LATE NOTES: At right are three sets of moving averages. The three Dow MA's are still in the bullish mode in that the 5-week is above the 13-week (just barely) and the 13-week is above the 50-week. The PTI is definitely in the bullish mode. But gold is in a bearish mode with the 5-week MA below the 13-week and the 13-week in turn below the 50-week.

Considering that the Dow topped out almost two months ago (June 16) and the A-D ratio topped out on the same day, the PTI has really held remarkably well. Note (p. 2 chart) how much stronger the PTI looks than either the Dow or the A-D. If this continues it will be most impressive.

Also, almost all secondaries and bear markets in the past have started with divergences between the Dow and the A-D ratio. But this has not happened in the current market in that the Dow and the A-D ratio topped out together on June 16. Normally, we would expect to see a series of new highs in the Dow unconfirmed by the PTI prior to an important downward move in the market.